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Legislative Audit Division

State of Montana

Report to the Legislature

August 2005

Financial-Related Audit

For the Two Fiscal Years Ended June 30, 2005

The University of Montana (All Campuses)

We performed a financial-related audit of The University of Montana for the two fiscal years ended June 30, 2005. This audit covered all four campuses affiliated with The University of Montana: The University of Montana-Missoula; Montana Tech of The University of Montana; The University of Montana-Western; and The University of Montana-Helena College of Technology. This report contains two recommendations to the University concerning internal control and compliance with state and federal laws and regulations related to:

- University Funds Held by the Foundations
- Federal Grants and Contracts

The financial audit of The University of Montana's consolidated financial statements for the fiscal year ended June 30, 2004, was issued in a separate report in December 2004 (04-10). The financial statement audit for the fiscal year ended June 30, 2005, will be issued in December 2005 (05-10).

Direct comments/inquiries to:
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A Financial-Related audit is a component of the biennial financial-compliance audit. In these audits, the Financial-Related and Financial audits are combined for a two-year period to constitute the financial-compliance audit. Financial-compliance audits are classified as Financial Audits according to Government Auditing Standards. The primary objectives of the Financial-Related audits are to determine compliance with regulations relating to contract and grant expenditures, other governmental financial assistance, and to test compliance with requirements of selected state laws, regulations, and rules. In performing the audit work, the audit staff uses standards set forth by the American Institute of Certified Public Accountants and the United States Government Accountability Office. Financial-compliance audit staff members hold degrees with an emphasis in accounting and most staff members hold Certified Public Accountant (CPA) certificates.

Government Auditing Standards, the Single Audit Act Amendments of 1996 and OMB Circular A-133 require the auditor to issue certain financial, internal control, and compliance reports. This individual agency audit report is not intended to comply with these reporting requirements and is therefore not intended for distribution to federal grantor agencies. The Legislative Audit Division issues a statewide biennial Single Audit Report which complies with the above reporting requirements. The Single Audit Report for the two fiscal years ended June 30, 2005, will be issued by March 31, 2006. The Single Audit Report for the two fiscal years ended June 30, 2003, was issued on March 23, 2004. Copies of the Single Audit Report can be obtained by contacting:

Single Audit Coordinator
Office of Budget and Program Planning
State Capitol
Helena MT 59620
Phone (406) 444-3616

Legislative Audit Division
Room 160, State Capitol
PO Box 201705
Helena MT 59620-1705

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August 2005

The Legislative Audit Committee
of the Montana State Legislature:

This is our financial-related audit report of The University of Montana (All Campuses) for the two fiscal years ended June 30, 2005. A financial-related audit is a component of the biennial financial-compliance audit. In these audits, the financial-related and financial audits are combined for a two-year period to constitute the financial-compliance audit. We issue a financial audit report on the University's consolidated financial statements annually. We issue a financial-related audit report every other year. The fiscal year 2003-04 financial audit of The University of Montana's consolidated financial statements was issued in December 2004. The financial audit for fiscal year 2004-05 will be issued in December 2005.

This audit report includes recommendations related to internal control and compliance with state and federal laws and regulations.

We thank the president and University staff for their assistance and cooperation during the audit.

Respectfully submitted,

Scott A. Seacat
Legislative Auditor

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Legislative Audit Division

Financial-Related Audit
For the Two Fiscal Years Ended June 30, 2005

The University of Montana (All Campuses)

Members of the audit staff involved in this audit were Danielle Gamradt, Jeane Carstensen-Garrett, Cindy S. Jorgenson, Paul J. O'Loughlin, Laura L. Norris, Vickie Rauser, and Jeff Tamblyn.

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Appointed and Administrative Officials

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	Linda McCullough, Superintendent of Public Instruction*	
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	Susan B. Patton	Interim Vice Chancellor for Academic Affairs and Research, University Associate Provost
	Joseph F. Figueira	Vice Chancellor for Research, Graduate Studies, and International Programs, University Associate Vice President
	John C. Badovinac	Controller/Business Manager
	Lynn Job	Director of Accounting, Grants and Contracts

Appointed and Administrative Officials

The University of Montana-Western	Richard Storey	Chancellor, University Executive Vice President
	Karl E. Ulrich	Vice Chancellor for Academic Affairs
	Thomas R. Yahraes	Vice Chancellor of University Advancement
	Susan D. Briggs	Vice Chancellor for Administration & Finance, University Associate Vice President
	Virginia Dale	Director of Business Services
The University of Montana-Helena College of Technology	Daniel Bingham	Dean/CEO
	Barbara Yahvah	Interim Associate Dean for Academic Affairs
	Cristobal Valdez	Assistant Dean for Student Services
	Russ Fillner	Assistant Dean for Fiscal and Plant Operations

For further information on the University of Montana (All Campuses) contact:

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The University of Montana (All Campuses)

We performed a financial-related audit of The University of Montana (All Campuses) for the two fiscal years ended June 30, 2005. The previous report for the two fiscal years ended June 30, 2003, contained two recommendations. The University implemented both recommendations.

This report contains two recommendations directed to the University. Our recommendations address internal control and compliance with state and federal laws and regulations related to assets held by the foundations and federal grants and contracts.

The listing below serves as a means of summarizing the recommendations contained in the report, the University's response thereto, and a reference to the supporting comments.

Recommendation #1

We recommend the University:

A. Improve internal communication to ensure all University resources are recorded on the primary accounting records as required by state law, and
B. Record the School of Health Professions and Biomedical Sciences research endowment grant and the KMSM broadcast frequency exchange on the University's primary accounting records. 9

University Response: Concur. See page A-4

Recommendation #2

We recommend the University establish additional internal control to ensure compliance with federal regulations concerning subrecipient monitoring and technical and performance reporting 11

University Response: Concur. See page A-4

Introduction

Audit Objectives

We performed a financial-related audit of The University of Montana (All Campuses) for the two fiscal years ended June 30, 2005. The objectives of the audit were to:

1. Determine the University's compliance with state laws and regulations.
2. Determine the University's compliance with federal regulations applicable to its Student Financial Aid and Research and Development major federal programs, including the implementation of internal control over compliance.
3. Provide recommendations for improvement in management and internal controls.
4. Determine the implementation status of prior audit recommendations.

The fiscal year 2003-04 consolidated financial statements of The University of Montana were audited by our office and issued in a separate report (04-10) in December 2004. The fiscal year 2004-05 consolidated financial statements will be audited by our office and issued in a separate report (05-10) in December 2005.

In accordance with section 5-13-307, MCA, we analyzed the costs of implementing the recommendations made in this report. Each report section discloses the cost, if significant, of implementing the recommendation. Other areas of concern deemed not to have a significant effect on the successful operation of University programs are not specifically included in the report, but have been discussed with management.

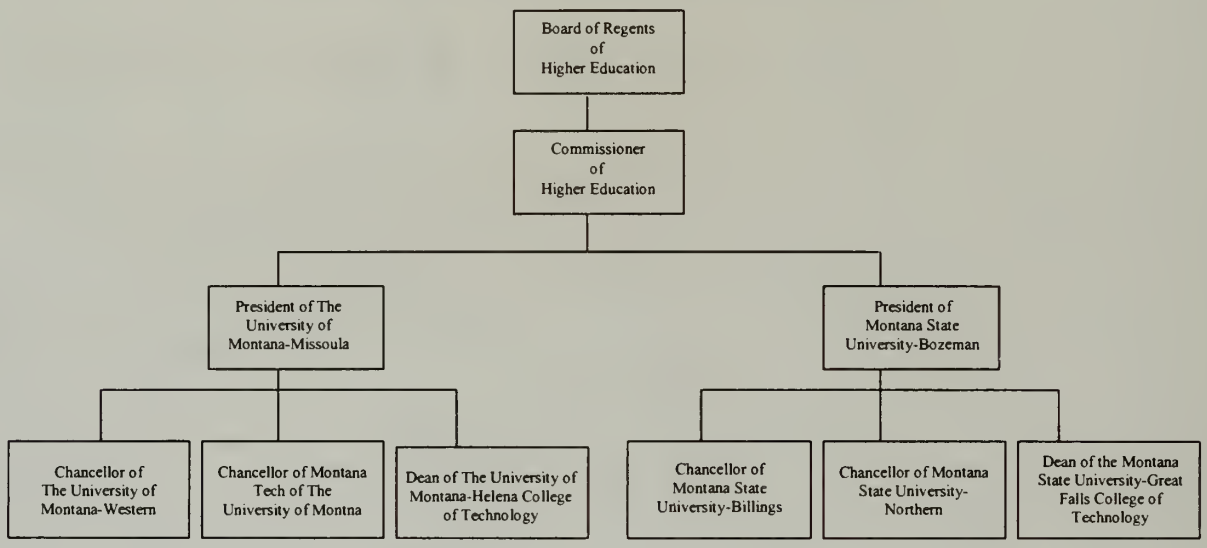
Background

The Board of Regents of Higher Education approved the current Montana University System structure in January 1994. The following chart illustrates the organization of the Montana University System.

Introduction

Figure 1

Montana University System Organizational Chart



Source: Compiled by the Legislative Audit Division.

The University of Montana consists of four campuses:

- The University of Montana-Missoula located in Missoula. The Forestry Conservation Station is associated with this campus.
- Montana Tech of The University of Montana located in Butte, which includes the Bureau of Mines.
- The University of Montana-Western located in Dillon.
- The University of Montana-Helena College of Technology located in Helena.

All campuses are accredited by the Commission on Colleges of the Northwest Association of Schools and Colleges. The four campuses of The University of Montana provide a diversity of undergraduate and graduate academic and two-year vocational/technical programs to students.

In the fiscal year 2003-04, The University of Montana had 3,187.31 full-time equivalent (FTE) employees. The following table shows fiscal year 2003-04 actual FTE by campus and type. Actual FTE employee data for fiscal year 2004-05 is not yet available.

Table 1

The University of Montana
Actual Full-Time Equivalent Employees
Fiscal Year 2003-04

Agency	Contract Faculty	Contract Administrative	Contract Professional	Classified	Graduate Assistants	Part-Time & Other*	Total
The University of Montana-Missoula	722.95	110.97	130.07	1,059.80	149.40	279.32	2,452.51
Montana Tech of The University of Montana	137.83	6.83	95.93	119.26	17.26	44.53	421.64
The University of Montana-Western	64.40	10.15	24.48	61.61		21.69	182.33
The University of Montana-Helena College of Technology	36.00	4.00	7.83	24.20		14.43	86.46
Bureau of Mines		1.00	18.14	10.57	.14	1.74	31.59
Forestry Conservation Station	8.08	.24	1.99	2.17	.14	.16	12.78
Total	969.26	133.19	278.44	1,277.61	166.94	361.89	3,187.31

*This category includes permanent part-time non-faculty, non-classified employees and temporary employees.

Source: Office of Commissioner of Higher Education "MUS Operating Budgets 2004-2005" Schedule 18.

The following table shows The University of Montana student full-time equivalent (FTE) enrollments for fiscal year 2004-05. The average student FTE for the entire University system was 32,763.

Table 2

The University of Montana Student FTE
Semester Average for Fiscal Year 2004-05

Missoula	
Undergraduate Resident	6,967
Graduate Resident	1,115
Resident-College of Technology	873
Total Residents	**8,956**
Undergraduate Nonresident	1,879
Graduate Nonresident	563
Nonresident-College of Technology	41
Western Undergraduate Exchange Program-UM Missoula	507
Western Undergraduate Exchange Program-College of Technology	2
Total Nonresidents	**2,993**
TOTAL MISSOULA	**11,949**
Montana Tech	
Undergraduate Resident	1,375
Graduate Resident	61
Resident-College of Technology	264
Total Residents	**1,700**
Undergraduate Nonresident	111
Graduate Nonresident	26
Nonresident-College of Technology	8
Western Undergraduate Exchange Program-UM Tech	119
Western Undergraduate Exchange Program-College of Technology	8
Total Nonresidents	**271**
TOTAL MONTANA TECH	**1,971**
Western	
Undergraduate Resident	897
Undergraduate Nonresident	40
Western Undergraduate Exchange Program	132
TOTAL WESTERN	**1,068**
Helena College of Technology	
Resident	673
Nonresident	6
Western Undergraduate Exchange Program	5
TOTAL HELENA COLLEGE OF TECHNOLOGY	**684**
Total UM Resident	**12,225**
Total UM Nonresident	**2,684**
Total UM Western Undergraduate Exchange Program	**772**
Total University of Montana	**15,672**

Source: Office of Commissioner of Higher Education.

The University of Montana Funding

The overall level of state support for the Montana University System is determined by the Montana legislature. The legislature appropriates state funds, comprised of general fund and six-mill levy revenues, in a lump sum appropriation for the educational units and all other higher education programs except the research and public service agencies, community colleges and tribal college assistance programs. The Board of Regents then allocates the lump sum appropriation to the various programs and educational units included in the lump sum appropriation. Personnel from the Commissioner of Higher Education's Office indicate the Board of Regents' formula that allocates state funds to the educational units is based upon resident enrollment, an analysis of faculty salaries in states with similar per capita income, the academic program offerings of the University, the necessary support expenditures, Regent priorities and the amount of state funds available. The Commissioner of Higher Education's Office indicated in fiscal year 2004-05, resident students paid tuition amounting to 43 percent of the anticipated cost of their education.

The University of Montana-Missoula

The University of Montana-Missoula was established in 1893 in Missoula as a comprehensive university. The campus offers four-year undergraduate programs along with masters and doctoral graduate programs. It includes professional schools and significant research activities. The campus is the center of liberal arts education in the Montana University System and operates the only law school in the system. Other schools include Business Administration, Education, Fine Arts, Forestry and Conservation, Health Professions and Biomedical Sciences, and Journalism. In addition, the campus includes a two-year college of technology, which provides a broad range of technical and occupational education and training courses. College of technology students receive either a certificate of completion or a two-year degree upon completion of a program.

Montana Tech of The University of Montana

Montana Tech of The University of Montana was established in 1893 in Butte as the Montana School of Mines. It provides a variety of four-year and graduate programs with a focus on mineral, geological, environmental, petroleum, mining and other engineering

and science programs and majors. It also includes a college of technology, which provides core education courses and two-year degrees in various occupational and technical programs.

The University of Montana-Western

The University of Montana-Western was established in 1893 in Dillon as the state's Normal School for Teacher Education. It provides both two-year and four-year undergraduate degree programs with a focus on elementary and secondary education. It also provides a four-year liberal arts degree with several emphases that complement the education programs.

The University of Montana-Helena College of Technology

The University of Montana-Helena College of Technology was established in 1939 in Helena as a Vocational-Technical School. It is a two-year institution of higher education. It offers an Associate of Science or Arts Degree in General Transfer for students who want to acquire a core of coursework transferable to university system baccalaureate programs throughout the state. It also offers a variety of occupational, technical, and training specialties, including accounting, construction, computer, electronics and welding technologies, and practical nursing. Students enrolled in these programs receive either a certificate of completion or a two-year degree. The Helena College of Technology is also expanding its offerings as a higher education center by hosting and facilitating graduate level study in cooperation with the entire Montana University System.

Prior Audit Recommendations

Our office performed a prior financial-related audit of The University of Montana (All Campuses) for the two fiscal years ended June 30, 2003. The University concurred with and implemented the two recommendations contained in the report.

Findings and Recommendations

Unrecorded University Resources

University personnel did not properly record University assets held by the foundations on the primary accounting records.

State law requires the University to record transactions on the state accounting system before the end of the fiscal year to present receipt, use, and disposition of all money and property for which it is accountable in accordance with Generally Accepted Accounting Principles (GAAP). During the audit we identified two instances where the University's resources, managed by its foundations, were not reflected on the University's accounting records. The following paragraphs summarize these instances.

Endowment Research Grant

During fiscal years 2002-03 and 2004-05, the School of Health Professions and Biomedical Sciences was awarded federal endowment grants totaling $5,311,500 to facilitate minority health and health disparities research. In January 2003, the University entered into an agreement with its foundation for the investment and management of these funds. Documentation indicates the foundation is holding the funds in the University's name.

University personnel recorded the revenues received from the federal government and subsequent transfer to its foundation in a restricted fund. It did not record these resources in an endowment fund as required by state law. An endowment fund is used to record resources when interest, but not the principal, is available for expenditure. University owned resources must be reflected on the primary accounting records, even when invested and managed by a foundation on the University's behalf. Endowment fund assets are understated by $937,000 and $1,874,000 at June 30, 2003 and 2004, respectively. In addition, endowment fund transfers-in are understated and restricted fund expenditures are overstated and transfers-out are understated by $937,000 and $937,000, for the fiscal years ended June 30, 2003 and 2004, respectively. Because the foundation manages the endowment resources, it was not efficient for us to determine the total asset and revenue misstatements in the endowment fund. Business Services personnel

processed correcting entries for the fiscal year 2004-05 activity once we notified them of this issue. They intend to quantify the total misstatements in order to correct the errors related to fiscal years 2002-03 and 2003-04 as well.

The Office of Research and Sponsored Programs administers the endowment grant and established the agreement with the foundation. Its management did not realize the resources needed to be recorded in the endowment fund and transferred the funds to the foundation without notifying Business Services personnel. Such notification is essential to the timely and proper recording of resources on the University's primary accounting records.

KMSM Broadcast Frequency Exchange

The Associated Students of Montana Tech (ASMT) operate KMSM, a radio station. In December 2001, the ASMT, with approval of University management, contracted with the Idaho Broadcasting Consortium to exchange broadcast frequencies. ASMT received $40,000 compensation for the frequency exchange. These University resources were deposited with the foundation without being recorded on the University's primary accounting records.

As discussed previously, University owned resources must be reflected on the primary accounting records even when managed by a foundation on its behalf. Because ASMT is an activity of the University, these resources belong to the University. Designated fund revenues are understated by $20,000 and $10,000 for the fiscal years ended June 30, 2003 and 2004, respectively. During this time period, ASMT used a portion of these resources to purchase equipment and make station improvements. As a result, expenditures are understated by $24,864 for the fiscal year ended June 30, 2004. Assets are also understated by $20,000 and $5,136 at June 30, 2003 and 2004, respectively. Accounting personnel processed correcting entries to properly reflect net assets related to the exchange on the primary accounting records at June 30, 2005, once we notified them of this issue.

KMSM and ASMT management agreed to use the proceeds of the exchange for station improvements and equipment rather than operations. To ensure the funds were not used for operations, KMSM management directed the resources go to the foundation. KMSM management did not consult with accounting personnel about the proper accounting treatment for this transaction.

Summary

In both of these instances, appropriate personnel were not notified of the decision to allow the foundations to hold these resources. This communication is an essential part of recording transactions in accordance with GAAP. We believe the University's internal communication should be improved to ensure University resources are completely and accurately recorded on the accounting records.

Recommendation #1

We recommend the University:

A. Improve internal communication to ensure all University resources are recorded on the primary accounting records as required by state law, and

B. Record the School of Health Professions and Biomedical Sciences research endowment grant and the KMSM broadcast frequency exchange on the University's primary accounting records.

Research and Development Internal Control and Compliance

University personnel can improve internal control and compliance with the subrecipient monitoring and technical and performance reporting requirements.

The University's Office of Research and Sponsored Programs is responsible for administering the University's Research and Development (R&D) federal grants. A R&D grant is an award from a federal agency, which focuses on a specific research or development activity. Each award has its own specialized goals and requirements. The University expended approximately $32 million

in fiscal year 2003-04 and $35 million in fiscal year 2004-05 under these awards.

The Office of Management and Budget (OMB) Circular A-133 requires the University to maintain internal control over federal programs to provide reasonable assurance it manages the programs in compliance with laws, regulations and provisions of the contracts or grant agreements. During our audit, we identified instances of non-compliance with two requirements. Based on the work performed, we believe the University should improve its internal control and compliance with applicable federal requirements.

Subrecipient Monitoring

As a pass-through agency for R&D federal awards, OMB Circular A-133 requires the University to monitor the R&D funds disbursed to subrecipients. This monitoring includes obtaining and reviewing audit reports of its subrecipients, issuing a management decision within six months of the report review, ensuring the subrecipient takes corrective action for audit findings affecting R&D expenditures and determining if the University must adjust its records for the audit findings. Subrecipients expending more than $500,000 in federal funds in a fiscal or calendar year must have a single or program-specific audit on an annual or biennial basis.

We reviewed subrecipient monitoring procedures applied to 15 of the University's 317 subrecipients. In each instance, University personnel only obtained the audit reports available at the time the subgrant agreement was signed. The reports obtained did not address the period of each subgrant. As a result, this procedure does not provide adequate assurance that the subrecipient administered the funds in accordance with applicable federal regulations. Additional audit reports addressing the time period of each subgrant may have been available, but were not requested or obtained for review. The potential exists for University personnel to be unaware of subrecipient noncompliance with federal regulations, including questioned costs.

Additional audit reports are obtained and reviewed only when a subsequent agreement is negotiated with the subrecipient. Based on our review, we believe University personnel should incorporate submission of audit reports as a condition of the grant agreement, providing the University with recourse when subrecipients do not submit the required reports.

Technical and Performance Reporting

Technical and performance reporting requirements are placed on certain grant awards by the federal agency sponsoring the grant. We reviewed three of the largest federal R&D grants for compliance with these reporting requirements.

For each of the grants reviewed, we identified untimely reporting. The technical and performance reports were submitted between one month and four and one-half months late. Each grant is assigned a Principle Investigator (PI). The PI is the person responsible for the technical and performance reporting requirements. In two instances, the PI's overlooked the reporting deadline. In one instance, the PI believed the final report deadline was extended when a new cooperative agreement was established. In all three instances, the reports were not submitted until an outside party inquired about their status.

According to University personnel, untimely completion of technical or performance reports limits the University's ability to draw federal funds. The PI's are made aware of their responsibilities concerning technical and performance reports through training and other available policies. We believe these procedures can be improved if the Office of Research and Sponsored Programs monitors PI submission of technical and performance reports.

Recommendation #2

We recommend the University establish additional internal control to ensure compliance with federal regulations concerning subrecipient monitoring and technical and performance reporting.

University Response

The University of Montana

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10 August 2005

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Legislative Auditor
Legislative Audit Division
Room 135 State Capitol
P. O. Box 201705
Helena, MT 59620-1705

RECEIVED
AUG 11 2005
LEGISLATIVE AUDIT DIV.

Dear Mr. Seacat:

We compliment the Legislative Audit staff for their cooperation and completion of The University of Montana Financial-Related Audit for the two fiscal years ended 30 June 2005. We found the audit team proceeded very expeditiously and cordially, as always.

We appreciate the cooperative efforts made by the audit team and thank those involved for their assistance. We will continue to make improvements and strive for precision in our processes. Also, we remain committed to compliance with regulations and assuring accountability for The University of Montana.

Sincerely,

George M. Dennison
President

GMD/ab
Denlet3024

c: R. Duringer, Vice President for Administration and Finance
D. Dwyer, Vice President for Research and Economic Development
S. Stearns, Commissioner of Higher Education

An Equal Opportunity University

The University of Montana

Response to Legislative Audit Division
Financial Related Audit
For Fiscal Years Ended 30 June 2005
July 2005

RECOMMENDATION #1
WE RECOMMEND THE UNIVERSITY:

A. **IMPROVE INTERNAL COMMUNICATION TO ENSURE ALL UNIVERSTIY RESOURCES ARE RECORDED ON THE PRIMARY ACCOUNTING RECORDS AS REQUIRED BY STATE LAW, AND**
B. **RECORD THE SCHOOL HEALTH PROFESSIONS AND BIOMEDICAL SCIENCES RESEARCH ENDOWMENT GRANT AND THE KMSM BROADCAST FREQUENCY EXCHANGE ON THE UNIVERSITY'S PRIMARY ACCOUNTING RECORD.**

The University concurs with the recommendation. The University will record the noted asset entries on the University's accounting records by fiscal year end, 30 June 2005. University personnel will implement procedures by 30 September 2005 to inform relevant University offices of all assets coming to the University from grant-funded activity. University Business Services personnel will also develop and implement procedures by 31 December 2005 to monitor fiscal activity between the Foundation and University, ensuring appropriate accounting.

Montana Tech of The University of Montana and the Tech Foundation will formalize donation procedures to ensure proper depositing of donations by both entities, implementing the revised procedures by 29 July 2005.

RECOMMENDATION #2
WE RECOMMEND THE UNIVERSITY ESTABLISH ADDITIONAL INTERNAL CONTROL TO ENSURE COMPLIANCE WITH FEDERAL REGULATIONS CONCERNING SUBRECIPIENT MONITORING AND TECHNICAL AND PERFORMANCE REPORTING.

The University concurs with the recommendation. University research administration personnel will modify procedures to ensure compliance with applicable federal regulations. The Office of Research and Sponsored Programs (ORSP) will implement a subrecipient monitoring database and revised procedures by 30 September 2005.

Current procedures include provisions for notifying PIs of their technical and performance reporting requirements. ORSP also conducts training that emphasizes these requirements. By 30 September 2005, ORSP will notify all PIs of the audit finding and stress the importance of meeting their reporting requirements on time.